

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

ORIGINAL

75-7047

To be argued by
ROBERT S. CHURCHILL

In The
United States Court of Appeals
For The Second Circuit

B
P/S

SAMUEL KOPET,

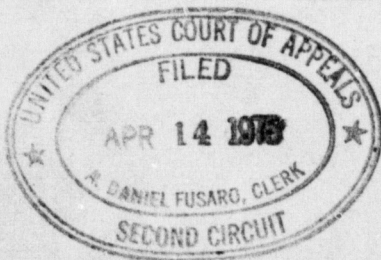
Appellant,

vs.

**ESQUIRE REALTY COMPANY, BENJAMIN KAUFMAN,
GERALD S. KAUFMAN and NATHAN P. JACOBS,**

Appellees.

BRIEF FOR APPELLANT



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TABLE OF CONTENTS

	<u>Page</u>
Table of Authorities	1
Issues	1
Statement of the Case	3
A. Preliminary Statement	3
B. The Proceeding Below	3
C. The Errors of the Lower Court	7
D. Facts Relating to Results Achieved and Benefits Received	10
Argument	20
Point I - Plaintiff's Counsel Fees Should be Paid by Defendants Kaufman and Jacobs Because of their Blatant Refusal to Conduct the Affairs of Esquire in Accordance with Legal Requirements	20
Point II- Alternatively, Plaintiff's Counsel Fees Should be Paid by Esquire, Since the Services Rendered have Signifa- cantly Benefited all Limited Partners of Esquire and Esquire itself	22
A. The Basis for an Award of Counsel Fees, where All Limited Partners are Benefited..	22
B. The Lower Court Misinterpreted the Stand- ard for Awarding Counsel Fees Where All Limited Partners Have been Benefited	29
Point III- Defendants Should pay Plaintiff's Counsel Fees because, if such Fees are Paid from Money Reimbursable to Limited Partners who Elect to Rescind, the Rescission Remedy will be Rendered Meaningless	39
Conclusion	44

TABLE OF AUTHORITIES

<u>A. Cases</u>	<u>Page</u>
<u>Abrams v. Textile Realty Corporation,</u> 97 N.Y.S. 2d 492 (Sup. Ct. N.Y.Co. 1949)	27, 28, 34
<u>Arenson v. Board of Trade of City of Chicago,</u> 71 C. 855 (N.D. 111, E.D. February 11, 1974, Bauer, J.)	26, 30, 34, 43
<u>Birnbaum v. Newport Steel Corp.,</u> 193 F2d 461 (2d Cir. 1952) Cert. Den. 343 U.S. 956 (1952)	26
<u>Gerstle v. Gamble-Skogmo,</u> 478 F.2d 128 (2d Cir. 1973)	21, 31, 32, 33
<u>Hall v. Cole,</u> 412 U.S. 1 (1973)	21, 26, 34, 35, 36
<u>J.I. Case v. Borak,</u> 377 U.S. 426 at pp. 432-433 (1964)	43
<u>Jones v. 30 Sutton Place Corporation, Misc.</u> 2d 406, 228 N.Y.S.2d 374 (Sup. Ct. N.Y.Co. 1962)	28
<u>Mills v. Electric Auto-Lite,</u> 396 U.S. 375 (1970)	23, 24, 25, 26, 27, 31, 32, 33, 34, 35, 36, 37, 38
<u>Sprague v. Ticonic National Bank,</u> 307 U.S. 161 (1939)	22, 23, 34, 37, 43, 44

Cases

Page

Trustees v. Greenough, 105 U.S. 527 (1881) 23

Vaughan v. Atkinson, 369 U.S. 527, 530-536
(1962) 21

B. Statutes and Rules

New York State General Business Law 6
Section 352e

Securities Act of 1933
Section 5 4
Section 11 30
Section 12 4, 30
Section 17 5

Securities Exchange Act of 1934
Section 10(b) 5
Rule 10b-5 5, 30, 39

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

-----X

SAMUEL KOPET,

Plaintiffs-Appellants,

Docket No.
75-7047

-against-

ESQUIRE REALTY COMPANY, BENJAMIN
KAUFMAN, GERALD S. KAUFMAN and
NATHAN P. JACOBS,

Defendants-Respondents.

-----X

APPELLANT'S BRIEF

ISSUES

1. Should individual defendants who are the controlling general partners of a limited partnership, be required to pay the counsel fees of a successful plaintiff in a class action, where the blatant refusal of such defendants to conduct the affairs of the limited partnership in accordance with legal requirements, including securities laws requirements, was the sole cause of the violations of law in question?

The Court below answered in the negative. Appellant respectfully submits that this issue should have been answered in the affirmative.

2. In the alternative, should the successful plaintiff's attorneys' fees be paid by the defendant limited partnership, where the services rendered by plaintiff's attorneys significantly benefited, not only the class members, but all limited partners and the limited partnership itself?

The court below answered in the negative. Appellant respectfully submits that this issue should have been answered in the affirmative.

3. Should defendants in a class action, wherein the court has granted the remedy of rescission in favor of the class, be ordered to pay the successful plaintiff's attorneys' fees if payment of such fees out of the money to be rescinded would significantly interfere with the effectiveness of the rescission remedy?

The court below answered in the negative. Appellant respectfully submits that the issue should have been answered in the affirmative.

STATEMENT OF THE CASE

A. Preliminary Statement

This appeal is from an order dated December 10, 1974, wherein Judge Metzner denied plaintiff's application for an order directing that plaintiff's attorneys' fees in connection with the successful prosecution of this action be paid by defendants Benjamin Kaufman ("Kaufman") and Nathan P. Jacobs ("Jacobs") or, alternatively, by defendant Esquire Realty Company ("Esquire"). For the reasons hereinafter shown, the motion should have been granted.

B. The Proceedings Below

This action was brought on behalf of plaintiff and all limited partners of Esquire similarly situated in an effort to remedy two breaches of duty on the part of the defendant general partners, as follows:

(a) The defendant general partners, acting on behalf of Esquire, a publicly held limited partnership, sent a letter dated November 1, 1971 (the "Letter"), to all of the then existing limited partners of Esquire, which offered an additional \$200,000 worth of limited partnership interests. This offering was a public offering made without any effective registration statement or prospectus. Limited partners of

Esquire purchased an aggregate of \$131,250 of additional limited partnership interests as a result of such offering.

(b) The Limited Partnership agreement of Esquire and the original Prospectus of Esquire which was distributed in connection with its 1962 public offering of limited partnership interests required that annual financial reports, certified by independent certified public accountants, be furnished each year to each limited partner. Despite such requirement, the general partners of Esquire had never sent any certified financial statements to the limited partners who were kept in the dark with respect to the financial affairs of Esquire.

As will be shown below, the commencement and prosecution of this action succeeded in remedying the breaches of duty described in (a) above, remedied in significant part the breach of duty described in (b) above and benefited all limited partners and Esquire itself in numerous additional ways.

The following is a more detailed description of the counts of the complaint herein:

(1) Count I of the complaint charged defendants with violating Sections 5 and 12 of

the Securities Act of 1933 (the "33 Act") by selling and offering to sell, by means of the Letter, \$200,000 of additional limited partnership interests in Esquire without an effective registration statement. Plaintiff obtained summary judgment on this count.

(ii) Count II charged defendants with violating Section 10(b) of the Securities Exchange Act of 1934 (the "34 Act") and Rule 10b-5 promulgated thereunder and Section 17 of the 33 Act by selling and offering to sell the securities by means of the Letter which contained untrue statements of fact and omitted to state material facts necessary to make the statements made not misleading. Plaintiff voluntarily discontinued this count on the ground, as stated to the lower court, that the relief obtainable on plaintiff's summary judgment on Counts I and III yielded all the benefit that could be obtained under Count II were it successfully prosecuted. The court below approved the dismissal of Count II.

(iii) Count III charged defendants with making a public offering and sale of securities in the State of New York without

first filing with the Department of Law of the State of New York, as required by Section 352e of the New York State General Business Law. Plaintiff obtained summary judgment on this count.

(iv) Count IV charged defendants with failing to provide annual certified financial statements to the limited partners. This count was dismissed for lack of pendent jurisdiction. However, as will be shown below, plaintiff's prosecution of this action was the direct cause of enabling all limited partners of Esquire to achieve a significant portion of the relief sought under this count.

(v) Count V sought an accounting of the profits realized and expenditures made by Esquire. This count was also dismissed for lack of pendent jurisdiction, but plaintiff's prosecution of this action was the direct cause of enabling all limited partners of Esquire to achieve a significant portion of the relief sought under such count.

At the same time that the lower court granted plaintiff's motion for summary judgment on Counts

I and III, the court granted plaintiff's motion that the action be maintained as a class action on behalf of the named plaintiff and all other limited partners of Esquire who bought additional Limited Partnership Interests pursuant to the Letter.

C. The Errors of the Lower Court

In its decision of December 10, 1974, denying plaintiff's motion for an award of counsel fees against defendants, the lower court based the denial solely on the following holdings:

1. By virtue of the ordered remedy of rescission, a common fund has been created out of which attorneys' fees must be awarded;

2. This is a representative suit, not a derivative suit; and

3. The benefits conferred on the non-class members are to be found only in the counts which the court dismissed for lack of pendent jurisdiction (Counts IV and V).

As will be shown more fully hereinafter, the lower court's determination was erroneous because:

1. A common fund was not created in this action since no damages or lump sum

recovery were obtained. Rescission is a wholly statutory remedy which does not create a "fund" but merely confers a right on such class member to opt to tender back his additional partnership interests in exchange for his own money. Significantly, the lower court's order of March 27, 1975, concerning the rescission does not provide for the creation of a common fund, but merely confers on a class member the right to advise the court of his desire to rescind his purchase, in which event Esquire will be required to return his purchase price (plus interest, and less dividends). Therefore, by its own order, entered subsequent to its denial of plaintiffs' motion for counsel fees, the lower court has acknowledged that no common fund exists. Moreover, as will be shown below, the mere existence of a common fund, even if there were one here, does not bar an award of counsel fees against defendants;

2. Awards of counsel fees against defendants are wholly permissible in representative actions and, contrary to the finding of the lower court, are not limited to derivative actions; and

3. Significant benefits have been conferred by this action on all limited partners and Esquire itself, not only on those limited partners who are class members, it will be hereinafter shown that such benefits relate both to the counts on which plaintiffs obtained summary judgment and on the counts dismissed for lack of pendent jurisdiction. Significantly, the lower court recognized that under the dismissed counts all limited partners had in fact been benefited. It said in its opinion:

"It is claimed that the institution of this action has created benefits for all the limited partners in defendant Esquire Realty. However, those benefits really are to be found in the counts which the court dismissed." (Appendix, p. 60a)

However, the lower court concluded, as a matter of law, that benefits obtained under the counts dismissed for lack of pendent jurisdiction did not provide a basis for an award of fees against defendants. As will be hereinafter shown, the lower court's legal determination on this point was erroneous.

D. Facts Relating to Results Achieved and Benefits Realized

Financial Statements Obtained, Illegal Loans
Discovered and Secret Sale of Esquire's Prin-
cipal Asset Uncovered

In support of its application for counsel fees, plaintiff submitted an affidavit of David M. Gerstein sworn to June 11, 1974. Defendants did not submit any answering affidavit. The following uncontradicted and undisputed facts appear from the moving affidavit:

Prior to this action, the defendant general partners had managed and controlled Esquire as if it were a private fiefdom. (Appendix at p. 31a). From the time of its organization, in 1962, they had supplied negligible information to the limited partner investors. (Appendix at p. 31a). Despite the fact that the Limited Partnership Agreement and the Esquire Prospectus required that each limited partner be furnished with a financial statement on an annual basis, certified by independent public accountants, such statements had never been furnished. (Appendix at p. 31a). As essential fact concealed was that defendants Kaufman and Jacobs had borrowed tens of thousands of dollars from Esquire between 1962 and 1972. (Appendix at p. 32a). In addition, prior to the public offering of November 1, 1971, adjudicated in this action to be in violation of Sections 5 and 12 of the 33 Act, defendants Kaufman and Jacobs caused a substantially identical

public offering to be made of additional limited partnership interests in Esquire without the filing of a registration statement or distribution of a prospectus. (Appendix at p.32a). In other words, prior to this action, the defendant general partners had wholly disregarded the contractual and statutory rights of the limited partners. (Appendix at p.32a).

The only information revealed to the limited partners during the entire period from 1962 until October 30, 1972, when this action was commenced, was contained in annual skeletal balance sheets and statements of profit and loss, which were unaudited, without footnotes and in such a form as to convey minimal information and conceal essential facts. (Appendix at p.32a).

The fact that defendants Kaufman and Jacobs had borrowed thousands of dollars from Esquire had not been previously disclosed to or known by any of the limited partners. (Appendix at p.32a). As the result of this action, such fact was revealed in the following manner: On February 5, 1973, plaintiff moved for summary judgment. (Appendix at p.32a). The moving affidavit of Stuart D. Wechsler, sworn to February 5, 1973, stated that although the Esquire Limited Partnership Agreement had required the general partners to provide the limited partners with certified financial reports, such reports had never been furnished. (Appendix at p.32a).

In opposition to that motion, defendants submitted an affidavit of defendant Benjamin Kaufman dated May 21, 1973 and filed with the lower court, as exhibits, copies of certified financial statements for the two years ended December 31, 1970 and December 31, 1971. (Appendix at p.33a). The submission of such financial statements constituted the first time that any certified financial statements relating to Esquire had ever been made public. (Appendix at p.33a). Such financial statements had never previously been sent to or seen by the limited partners and, in fact, had never even been previously prepared or available for inspection by anyone, despite a claim by Kaufman in his affidavit that such financial statements had always been available for inspection. (Appendix at p.33a). The opinion letters of the accountants who had prepared those financial statements and which accompanied those statements were dated May 18, 1973 and May 21, 1973, respectively, only five and three days before the return date of plaintiff's motion for summary judgment. (Appendix at p.33a). Although Mr. Kaufman claimed that such statements had always been available for inspection, it would have been impossible to inspect 1970 and 1971 financial statements which had not been prepared until May of 1973. (Appendix at p.33a). Such facts evidence that the audited financial statements for those years were prepared solely

because of the bringing of this action. (Appendix at p.33a).

A reading of page 8 of Kaufman's affidavit of May 21, 1973, submitted in connection with plaintiffs' motion for summary judgment, reveals the following additional statements:

"The audited statements for the years 1963 through 1971 are being xeroxed and copies thereof will be given to the attorneys for plaintiff on May 22, 1973.

"The 1972 audited statement will be given to plaintiff's attorneys within two (2) weeks from the date hereof. " (Appendix at p. 33a).

On June 5, 1973, Nathaniel M. Sokolski, one of the defendants' attorneys, delivered to the lower court the certified financial statements referred to in Kaufman's affidavit. (Appendix at p.34a).

In addition, in June of 1973, the 1972 certified statement was sent to all limited partners of Esquire. This was the first time in the history of Esquire that this had ever been done! (Appendix at p.34a).

In other words, solely as the result of the bringing of this action, all of the limited partners of Esquire received a financial statement for the fiscal year ended December 31, 1972 and plaintiff's attorneys

as the de facto representative of the limited partners, were able to obtain a certified financial statement for the 1973 fiscal year. further evidence of the benefits achieved by this action. (Appendix at p.34a).

A reading of the certified financial statements submitted to the lower court suffices, without more, to show why the defendant general partners had kept the limited partners in the dark. (Appendix at p.34a). Schedule 11 of each statement reveals borrowings from Esquire by defendants Kaufman and Jacobs in the aggregate amount of hundreds of thousands of dollars. (Appendix at p.35a). The following table which appears at page 7 of the moving affidavit, taken from such certified financial statements, sets forth the amounts of the borrowings, repayments and balances owing for each year:

<u>As of December 31</u>	<u>Balance receiv- able at begin- ning of period</u>	<u>Borrowings</u>	<u>Repayments</u>	<u>Closing Balance</u>
1962	(\$200,277.75)	\$252,215.80	None	\$ 51,938.05
1963	51,938.05	Not available	\$ 7,849.45	44,688.50
1964	44,688.50	None	None	44,688.50
1965	44,688.50	None	1,072.91	43,615.59
1966	43,615.59	None	1,500.00	42,115.59
1967	42,115.59	75,000.00	40,000.00	77,115.59
1968	77,115.59	None	20,000.00	57,115.59

<u>As of December 31</u>	<u>Balance receiv- able at begin- ning of period</u>	<u>Borrowings</u>	<u>Repayments</u>	<u>Closing Balance</u>
1969	57,115.59	\$ 80,000.00	\$ 63,000.00	\$ 74,115.59
1970	74,115.59	70,000.00	70,000.00	74,115.59
1971	74,115.59	195,000.00	185,000.00	84,115.59
1972	84,115.59	65,000.00	20,000.00	129,115.59

The above table clearly evidences that defendants Kaufman and Jacobs had been using Esquire as their private bank from which borrowings could be made without prior approval. without any interest or security and without disclosure to any of the limited partners. (Appendix at P. 35a).

Furthermore, note 6 of the financial statement for the fiscal year ended December 31, 1972 revealed the vital fact that the general partners had contracted to sell Esquire's principal asset, its leasehold interest in the Esquire Building in Chicago. (Appendix at p. 35a). The limited partners had never been advised of this fact and were wholly unaware of it. (Appendix at p. 36a). The note indicates that \$910,000 was received by the general partners as a deposit on account (which has never been accounted for); that a closing would not take place for 5 years and that, in the interim, the net lease rent on the Building was to be reduced by 25%. (Appendix at p. 36a). Solely as a result of this action, the limited

partners discovered the existence of such transaction.
(Appendix at p.36a).

As a result of the facts revealed by the above described financial statements a great deal of the relief sought by Counts IV and V of the complaint, though dismissed on jurisdictional grounds, has been obtained. (Appendix at p.36a).

The revelation of the illegal borrowings and the leasehold sale described above supplied the limited partners of Esquire with information sufficient to enable them to commence an action in the Supreme Court of the State of New York, New York County, on behalf of Esquire against the defendant general partners seeking, inter alia, repayment of the outstanding amount of the loans, interest on all borrowings over the 10 year period involved, payment to Esquire of all profits realized by the general partners from their use of borrowed funds and a complete accounting concerning the leasehold sale. (Appendix at p.36a).

It is certain that without the "watchdog" function that plaintiff's law firm has performed in this action, the limited partners would still never have received any certified financial statements of Esquire, never have learned of the illegal borrowings of hundreds of thousands of dollars from Esquire by defendants Kaufman

and Jacobs and never have uncovered the secret sale of Esquire's leasehold interest in the Esquire Building.

In causing disclosure of these matters, all limited partners, not just members of the specific class who purchased securities in 1971, have been significantly benefited from the fact that for the first time since Esquire's formation in 1962, the general partners were put on notice that representatives of the limited partners were carefully watching them and will continue to do so. No longer can the general partners operate on the private fiefdom theory as they had in the past.

Securities Laws Violations

The following additional uncontradicted and undisputed facts appear from the moving affidavit:

As a result of the granting of summary judgment on Counts I and III, the lower court decided that each limited partner who had purchased an additional limited partnership interest in the 1971 offering was entitled to rescission. (Appendix at p. 37a).

The order requiring rescission, while benefiting the individual members of the class who opt for rescission, also greatly benefits all limited partners since the effect of the judgment in this action is to inhibit future violations of the securities laws by

the defendant general partners. (Appendix at p.38a).

The violation complained of in Courts I and III of the complaint was not the first such violation on the part of the defendant general partners. (Appendix at p.38a). On at least two prior occasions, the defendant general partners herein committed the identical violation (i.e. the issuance of securities in a public offering without the filing of a registration statement). (Appendix at p.38a). Such other violations were as follows:

(a) In 1968, they caused Esquire to offer additional limited partnership interests to all limited partners and did actually sell such additional partnership interests without any registration statement or prospectus. (Appendix at p. 38a).

(b) In 1970, the same persons, as general partners of the Sherman Company, a New York limited partnership which owned the Sherman House Hotel in Chicago, made a public offering of securities to more than 700 limited partners pursuant to a letter dated May 29, 1970 and without any registration statement or prospectus. (Appendix at p.38a).

Had this lawsuit not been commenced, prosecuted and brought to a successful conclusion, there would have been no deterrent to continuing future violations of the

securities laws by the defendant general partners.
(Appendix at p.39a).

As a result of this action, they now know that future such violations will not be tolerated. (Appendix at p.39a). All limited partners benefit significantly from this. (Appendix at p.39a).

ARGUMENT

POINT I

PLAINTIFF'S COUNSEL FEES SHOULD BE
PAID BY DEFENDANTS KAUFMAN AND JACOBS
BECAUSE OF THEIR BLATANT REFUSAL TO
CONDUCT THE AFFAIRS OF ESQUIRE IN
ACCORDANCE WITH LEGAL REQUIREMENTS

Defendants Kaufman and Jacobs have managed Esquire's affairs since Esquire's initial public offering in 1962 in flagrant disregard of the rights of limited partners and of their legal obligations as general partners. The 1971 public offering complained of in this action was merely one instance of such breach of duty. Until this action was brought, they operated Esquire as they saw fit without recognizing the legal obligations owed to the limited partners. As appears from the moving affidavit described below, among those breaches of duty have been the following:

(1) their public offering made to the limited partners of Esquire in 1971 without the slightest attempt to comply with federal or state securities requirements;

(2) their earlier illegal public offering made to the limited partners of Esquire in 1968;

(3) their failure to furnish certified annual financial statements to the limited partners despite

their unequivocal legal obligation to do so;

(4) their illegal, secret borrowings of hundreds of thousands of dollars from Esquire between 1962 and the present (first uncovered as the result of this action) without any interest or security;

(5) their secret contract to sell Esquire's principal asset, the leasehold interest in the Esquire Building in Chicago (discovered only as the result of this action) and their failure to fully account to the limited partners for the more than \$900,000 in cash received in connection therewith.

Where, as here, the defendants have acted in such wanton disregard of the rights of security holders, federal courts have the power to require them to pay plaintiff's counsel fees. Hall v. Cole, 412 U.S. 1 (1973); Vaughan v. Atkinson, 369 U.S. 527, 530-536 (1962). Gerstle v. Gamble Skogmo, 478 F.2d 128 (2d Cir. 1973).

An award of fees on the basis of defendant's conduct is particularly appropriate in class actions where, as here, there is evidence of a long continued pattern of wanton acts in violation of the rights of class members.

Defendants Kaufman and Jacobs did not submit any affidavit disputing the facts contained in the moving affidavit. The court below did not dispute that they have been guilty of gross acts of impropriety and illegality to the damage of all of the limited partners. Nevertheless, it did not award fees against them.

POINT II

ALTERNATIVELY, PLAINTIFF'S COUNSEL FEES SHOULD BE PAID BY ESQUIRE, SINCE THE SERVICES RENDERED HAVE SIGNIFICANTLY BENEFITED ALL LIMITED PARTNERS OF ESQUIRE AND ESQUIRE ITSELF

A. The Basis for an Award of Counsel Fees, where All Limited Partners are Benefited

Far from benefiting only those limited partners of Esquire who purchased additional interests in 1971, this action has achieved a significant benefit for all limited partners of Esquire and for Esquire itself.

Such benefits, in addition to helping remedy past illegalities, will have the therapeutic effect of causing Esquire's management to conduct its future affairs in conformity with legal requirements.

It is well established that the defendant corporation will be required to pay the plaintiff's attorneys' fees in cases involving corporate therapeutics. Sprague v. Ticonic National Bank, 307 U.S.

161 (1939); Trustees v. Greenough, 105 U.S. 527 (1881). There is no reason for the same principle not to apply in the case of a limited partnership.

In the case of securities law violations, the appropriateness of payment by a defendant corporation of legal fees, where the action will encourage management to comply with the securities laws in the future, has been determined by the Supreme Court in Mills v. Electric Auto-Lite, 396 U.S. 375 (1970).

In the Mills case, the Court based an award of fees on the therapeutic benefits conferred upon all shareholders and the corporation itself in enforcing securities law obligations. The Court stated:

" . . . private stockholders' actions of this sort 'involve corporate therapeutic' and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute. To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful part

with the expense but to impose them on the class that has benefited from them and that would have had to pay them had it brought the suit. Id. at pp. 396-397. (Emphasis added.)

The Court in Mills also noted:

"In many suits under §14(a), particularly where the violation does not relate to the terms of the transaction for which proxies are solicited, it may be impossible to assign monetary value to the benefit. Nevertheless, the stress placed by Congress on the importance of fair and informed corporate suffrage, leads to the conclusion that, in vindicating the statutory policy, petitioners have rendered a substantial service to the corporation and its shareholders." Id. at p. 396. (Emphasis added.)

Similarly, plaintiff at bar has vindicated the legislative and statutory policy of full disclosure under the Federal Securities Acts by obtaining rescission of Esquire's unregistered offering. Certainly, the policy of full disclosure vindicated by this action goes as much to the heart of the securities acts as does the principle of corporate suffrage espoused in the Mills case.

The "therapeutics" involved in Mills are of particular importance in the case at bar where defendants Kaufman and Jacobs not only violated the 33 Act and New York State law in 1971 but also (a) caused a previous illegal public offering of the same type (i.e., a public offering based on a letter rather than a registration statement) to be made to Esquire's limited partners in 1968 and (b) caused a similar illegal public offering to be made in 1970 to the limited partners of a similar New York limited partnership, a large number of the limited partners of which are also Esquire limited partners.

It should also be noted that the rescission ordered in this action benefits all limited partners of Esquire, not just those who purchased additional interests in 1971. Those limited partners who did not purchase in 1971 suffered a dilution of their partnership interest in Esquire. Therefore, they were damaged in that they did not purchase (and, hence, were diluted) because they had not received factual data upon which to make an investment decision, data which would have been supplied if the defendants had complied with the full disclosure obligations under the

33 Act. Such breach of duty, however, could not be remedied by such non-purchasing limited partners by an action under the 33 Act or 34 Act since they were neither purchasers nor sellers. Birnbaum v. Newport Steel Corp. 193 F. 2d 461 (2d Cir. 1952), Cert. den. 343 U.S. 956 (1952). Thus, plaintiffs have benefited such non-participating limited partners by preventing future violations and, thereby, future illegal dilutions.

The court's decision in Mills was followed in Hall v. Cole, supra, where plaintiff's legal fees were ordered to be paid out of the defendant union's general funds. In Hall, plaintiff, claiming that his rights of free speech under the Landrum-Griffith Act had been abridged by the union, obtained an injunction restraining the union from further interference. The court found that the plaintiff's lawsuit had achieved the therapeutic result of aiding in the preservation of union democracy, and, therefore, had benefited all members of the union and the union itself.

In the very recent case of Arenson v. Board of Trade of the City of Chicago, 71 C. 855 (N.D. Ill., E.D., February 11, 1974, Bauer J.), the court awarded substantial counsel fees to the various plaintiffs in

that consolidated class action where an injunction had been obtained restraining the defendants from committing certain illegal acts in the Chicago commodities market. A copy of that decision is annexed hereto. As in Mills, the court based its award of counsel fees on the fact that the action had resulted in the enforcement of the securities laws, thereby requiring the defendants to comply with their legal obligations.

The policy behind the holding in Mills is that in a situation where all security holders are benefited, it is unfair to saddle plaintiffs with all of the fees and expenses of the litigation. In this regard, the Court in Mills stated that:

"To allow the others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich others unjustly at the plaintiff's expense." Mills v. Electric Auto-Lite, supra, at p. 392.

The Mills rule is applied by the courts of New York State.

In Abrams v. Textile Realty Corporation, 97 N.Y.S. 2d 492 (Sup. Ct. N.Y. Co. 1949) (not officially reported), the court awarded counsel fees to the plaintiff shareholders who had succeeded in restraining the commission of ultra vires acts by the principals of

the defendant corporation. The court found that the plaintiff's success in restraining the ultra vires acts was of benefit to the corporation and all of its shareholders even though the acts enjoined might have financially benefited both the corporation and the shareholders. The court stated:

"Hence, on the narrow issue of law as to 'the right' to an allowance, as distinct from issues of law and fact as to the amount of allowance, there is no relevance in an argument that this suit created no fund or property for Textile or its security holders, or that they or any of them would have been better off if the ultra vires act had been performed. The law cannot refuse to recognize as beneficial full observance of the law. The law cannot hold that corporate interests are better served by action outside rather than within the-law." Id. at p. 496 (Emphasis added.)

To the same effect, see Jones v. 30 Sutton Place Corporation, 34 Misc. 2d 406, 228 N.Y.S. 2d 374 (Sup. Ct. N.Y. Co. 1962).

In addition to the therapeutic benefits relating to the securities laws, each limited partner of Esquire has benefited significantly from this action by:

(1) Causing the defendants to live up to their contractual obligations to deliver certified financial statements, as heretofore described;

(2) enabling all limited partners to discover the breach of fiduciary duty by defendants Kaufman and Jacobs in secretly borrowing hundreds of thousands of dollars from Esquire as heretofore described;

(3) enabling all limited partners to discover the theretofore undisclosed sale of Esquire's principal asset; and

(4) **putting** defendants Kaufman and Jacobs on notice that their conduct of the affairs of Esquire will remain under close scrutiny by the limited partners and that Esquire can no longer be operated as a private fiefdom.

In view of all the benefits conferred on all of the limited partners, it would be improper and inequitable to impose plaintiff's attorneys fees on plaintiff himself or on that group of limited partners who purchased in 1971 and who elect to rescind.

B. The Lower Court Misinterpreted the Standard for Awarding Counsel Fees Where All Limited Partners Have been Benefited

No Common Fund Has Been Created

As shown above, the remedy of rescission ordered herein has not created a "common fund", as found by the

lower court, but has merely conferred upon the class members a statutory right to relief. Rescission under ¶ 12 of the '33 Act, like injunctive relief, is clearly distinct from the damages obtainable under ¶11 of the '33 Act or under Rule 10b-5 promulgated under the '34 Act.

A common fund is created where an award of damages to a class is made, not where a statutory remedy other than damages is obtained.

In Arenson v. Board of Trade of the City of Chicago, supra, where, as here, no damages were awarded, the court found that the monetary benefit to the class was nevertheless many millions of dollars. However, counsel fees were not awarded out of the benefit, but were taxed to the defendants.

Similarly here, the remedy of rescission will presumably result in a monetary benefit to the members of the class, but will not result in a "common fund" out of which fees may be awarded.

Therefore, the lower court erred in determining that a common fund had been created.

Even if A "Common Fund" Had Been Created
Here, the Fees Could Nevertheless be
Taxed Against Defendants

Defendants below cited Gerstle v. Gamble Skogmo, supra, in support of the proposition that where an action results in the creation of a "common fund", counsel fees must be awarded out of the "fund" and not taxed to the defendants. Gerstle is not relevant to the facts in this case.

In Gerstle the court held that Mills v. Electric Auto-Lite did not mandate an award to the plaintiff of counsel fees because, whereas in Mills no common fund had been created, in Gerstle there was an enormous recovery in damages, approximately \$12,000,000.

The court said:

"In contrast to Mills, when the action produces damages sufficient for counsel fees and expenses, payment of these from the fund imposes no burden on the stockholders who had taken the initiative, as distinguished from the entire class." Id. at p. 1309 (Underscoring added).

In this case the amount involved in the rescission is not sufficient for reasonable counsel fees without imposing an improper burden on those limited partners who elect to rescind. Thus, the basis of the court's determination

in Gerstle, that counsel fees could be paid from the common fund created by the huge award of damages in that action without imposing any burden on the stockholders, is wholly inapplicable here.

Furthermore, the court specifically noted that the defendant corporation, against which the counsel fees were sought, did not contain shareholders who had benefited by the action, stating:

"It should be noted that the present action was a class action on behalf of the stockholders of GOA other than Skogmo and that the latter does not share in the recovery."
Id. at p. 1309.

By contrast, Esquire and all the limited partners of Esquire are the major beneficiaries of this action.

Furthermore, in the concurring opinion in Gerstle, Judge Oakes, in clarifying the majority opinion, noted:

"It seems to me, however, that Mills went beyond this to say that the Court has power in a Section 14(a) suit to award attorneys' fees when circumstances make such an award appropriate. 396 U.S. 390-91. In the Mills opinion, the Court went on to say that:

'Nevertheless, the stress placed by Congress on the importance of fair and informed corporate

suffrage leads to the conclusion that, in vindicating the statutory policy, petitioners have rendered a substantial service to the corporation and its shareholders.' 396 U.S. at 396.

This it seems to me, gives a somewhat new and different basis for the awarding of attorneys' fees in an appropriate case - namely, that the plaintiffs have in effect enforced an important Congressional objective and as it has sometimes been put, have acted as private attorneys general." Id. at p. 1310.

Thus, even if a common fund had been created herein, the obvious therapeutic benefits achieved and the vindication of the statutory policy of full disclosure would fully justify an award of counsel fees against the defendants.

The interpretation of Gerstle advanced by the defendants below and apparently followed by the court below would mean that if a "common fund" of \$100 had been created, plaintiff's counsel fees would have to be paid out of that \$100 fund even if the services of such counsel had produced very great additional benefits for the company involved and its security holders. To merely advance such interpretation is to show its fallaciousness.

Awards of Counsel Fees Against Defendants
are by no Means Limited to Derivative Actions

The lower court misinterpreted the meaning of the Supreme Court decision in Mills v. Electric Auto-Lite,

supra, in finding that the Court's decision in that case, allowing counsel fees where there has been a therapeutic benefit to the corporation and its shareholders, is limited to derivative actions (Appendix, p. 60a).

In fact, Mills was both a class action and a derivative action. The award of counsel fees therein was not based on the fact that the action was derivative, but on the de facto therapeutic benefits achieved by the action.

The obvious propriety of awarding counsel fees to the plaintiff where a de facto therapeutic benefit has been realized, even where the action is not derivative, has been noted in numerous of the cases cited in Point II herein. Thus, counsel fees were awarded on the basis of the benefit achieved although the action was not derivative, in the following cases: Sprague v. Ticonic National Bank, supra; Hall v. Cole, supra; Arenson v. Board of Trade of the City of Chicago, supra; and Abrams v. Textile Realty Corporation, supra.

The Supreme Court has specifically found Mills to justify an award of counsel fees on the basis of the therapeutic benefits achieved in Hall v. Cole, supra, which was neither a class nor a derivative action. In Hall, the Court held:

"The instant case is clearly governed by this aspect of Mills." Id. at p. 7.

Accordingly, the lower court erred in finding that awards of counsel fees against defendants are limited to derivative actions.

The Summary Judgment Obtained by
Plaintiff Herein Substantially
Benefited All Limited Partners
of Esquire, Not Only the Class
Members

Judge Metzner erroneously concluded that the summary judgment granted by him, entitling the class members to rescind their purchases, only benefited those who chose to rescind. The court said:

"There is individual recovery for those who come forward and request it. There is no benefit conferred on anyone who does not seek to participate in the fruits of the judgment. Consequently, this application must be denied." (Appendix at p.60a).

The lower court, then, denied the motion on the ground that the only benefit conferred by the successful prosecution of this action is the monetary benefit of rescission. The lower court failed to grasp the heart of the matter - namely, that substantial "therapeutic benefits", as fully described above, were conferred on all limited partners of Esquire and Esquire itself. As seen above, these therapeutic benefits entitle plaintiff to an award of counsel fees against Esquire, since it would be unfair to saddle the class members with the cost of an action which benefited all limited partners of Esquire, class members and non-class members alike. Mills v. Electric Auto-Life, supra.

Similarly, it is settled that an award may be made against defendants where the benefit conferred is non-monetary. Hall v. Cole, supra.

The lower court, therefore, erred in tying its decision to the narrow issue of who stood to benefit solely

in a monetary sense.

Counsel Fees May be Awarded on the Basis
of Benefits Conferred Outside the Scope
of the Court's Judgment

The lower court limited its concept of "benefits" entitling a plaintiff to an award of fees to those benefits which are directly conferred by the court's order. The lower court noted with disapproval that many of the benefits conferred on all limited partners of Esquire and Esquire itself "really are to be found in the counts which the court dismissed. Those counts were common law counts and not in any way pendent to the federal claims." (Appendix at p.60a).

The fact remains, tacitly recognized by the court below, that benefits were conferred on non-class members as a result of plaintiff's prosecution of the action. This fact entitles plaintiff to the relief he seeks.

The actual benefit conferred by the plaintiff's efforts, rather than the specific nature of the relief granted by the court, is the standard for an award of counsel fees. Sprague v. Ticonic National Bank, supra; Mills v. Electric Auto-Lite, supra.

Thus, the therapeutic benefits conferred in Mills, like the therapeutic benefits conferred in this

action, are long term benefits unrelated to the direct impact of the court's judgment.

Obtaining ten years' worth of financial records, previously undisclosed to the limited partners; uncovering hundreds of thousands of dollars of illegal loans by Kaufman and Jacobs from Esquire; uncovering the leasehold sale of the Esquire Building - these are obviously very real benefits of great magnitude, though admittedly benefits conferred solely by plaintiff's efforts in the action, rather than the court's judgment. Under the de facto standard of determining benefit, employed by the court in Mills, it is obvious that these benefits entitle plaintiff to the relief sought.

All the substantial benefits conferred on all limited partners of Esquire and Esquire itself (itemized on pp.10-19 of this brief) constitute de facto benefits, whether or not the court explicitly conferred them, entitling plaintiff to relief.

4.

POINT III

DEFENDANTS SHOULD PAY PLAINTIFF'S COUNSEL
FEES BECAUSE, IF SUCH FEES ARE PAID FROM
MONEY REIMBURSABLE TO LIMITED PARTNERS
WHO ELECT TO RESCIND, THE RESCISSION
REMEDY WILL BE RENDERED MEANINGLESS

The lower court, in denying plaintiff's motion for an order directing that plaintiff's legal fees and disbursements be paid by defendants Kaufman and Jacobs or, in the alternative, by defendant Esquire, ordered that fees be awarded only out of the money to be refunded to class members.

Under the rescission ordered by the lower court limited partners who purchased additional partnership interests are entitled to their own money back. It is the statutory purpose to place them in status quo. The deduction of plaintiff's attorneys' fees from their own money upon rescission would defeat such statutory purpose.

In the usual successful shareholders' class action, such as one involving a violation of Rule 10b-5

promulgated under the 34 Act, damages are awarded from which plaintiff's counsel is compensated. Such actions ordinarily involve many thousands of individuals. The amount of the attorneys' fees is usually only a small percentage of the amount which each member of the class receives. Furthermore, as a result of the thousands of individuals ordinarily in the class, the usual class member has only a small economic interest in the outcome.

This case presents an entirely different situation. Here, there are only 186 individuals who purchased additional limited partnership interests in 1971 and they paid an aggregate consideration of \$131,250. Any substantial deduction from this sum will seriously affect individual class members.

In the lower court, plaintiff sought an award of attorneys fees to be paid by defendants, in the sum of \$25,000. When the lower court refused to order payment of such fees by defendants, but only payment out of the money to be refunded to class members, it became impossible to either be fair to the class or to plaintiff's attorneys. Obviously, if the Notice to the class had informed the class members of a possible impending diminution of \$25,000 in the monies to be refunded to class members, all of them would have opted

out of the class because no class member could have known how many of the other class members would elect to rescind; therefore, no-one would rescind since he would have no way of knowing how much money he would receive back. For example, if attorneys' fees of \$25,000 were awarded payable out of the rescission money and if an insubstantial number of class members sought rescission - e.g. in an amount of \$30,000 - each class member would receive virtually nothing pursuant to the rescission. Obviously, no reasonable class member would seek rescission under these circumstances, and the very remedy ordered by the lower court would be rendered meaningless.

Even if it were ordered that a percentage of the amount to be refunded to each class member be deducted to pay plaintiff's legal fees there would be the same inequitable result. If the percentage were too high, class members would be severely prejudiced and would not accept such a flawed remedy. If the percentage were too low, or if not enough class members opted for rescission (possibly as a result of the therapeutic results achieved in the action) the attorneys who produced the remedy and such results would not receive fair compensation.

It makes no sense for the court to order a remedy which actually discourages class members from

availing themselves of it and penalizes attorneys responsible for benefits achieved.

Under the circumstances which exist, because of the facts heretofore described, it is only fair and proper that Kaufman and Jacobs, be required to pay plaintiff's legal fees. It is they and they alone who are responsible for the illegal offering made in 1971; it is they who have caused previous illegal offerings to be made; it is they who were responsible for the failure to supply certified financial statements to the limited partners; and it is they whose illegal loans were revealed as a result of this action.

If defendants Kaufman and Jacobs are not required to pay plaintiff's legal fees, they will have sustained no adverse consequences whatever as a result of their breaches of duty. In fact, if plaintiff's counsel fees were imposed on members of the class, thereby inducing such members not to accept the rescission remedy, such defendants would in fact have triumphed in this case to the detriment of the members of the class and all other limited partners. In effect an injured class of limited partners would be paying for the cost of remedying illegal conduct on the part of general partners. Furthermore, unless such defendants are required to pay such fees, they will escape completely unscathed and not be effectively deterred from similar violations in

the future. This is not a proper result.

If this Court does not believe that the individual defendants should be required to pay such legal fees, at the very least the payment of such fees should be imposed upon Esquire itself since in this manner all of the members of the class as limited partners of Esquire, as well as all other limited partners, by their interest in Esquire, will have shared in such fees. This result would be fair in that Esquire itself and all its limited partners are the beneficiaries of the therapeutic benefits conferred as a result of the services of plaintiff's attorneys.

A federal courts have the power to prevent its own remedy from being impaired. It has the power to fashion broad, equitable relief to encourage the private enforcement of the securities laws. J. I. Case Co. v. Borak, 377 U.S. 426 at pp. 432-433 (1964).

This power has been exercised by federal courts to award counsel fees to the plaintiff. Sprague v. Ticonic National Bank, supra; Arenson v. Board of Trade of the City of Chicago, supra.

In Sprague, referring specifically to counsel fees, the Court noted:

"Plainly, the foundation of the historic practice of granting reimbursement for the costs of litigation other than the conven-

tional taxable costs is part of the original authority of the chancellor to do equity in a particular situation." Id. at p. 166.

It is hard to imagine a clearer case than that presented by this action justifying the exercise by this court of its equitable powers to require defendants to pay plaintiff's counsel fees, since any other order would defeat the remedy of rescission.

Thus, the success of this action depends upon the success of this application. Since plaintiff has already prevailed on the merits, he should not now be defeated on the questions presented for review on this appeal.

CONCLUSION

Defendants should be directed to pay plaintiff's counsel fees.

Dated: New York, New York
April 11, 1975

Respectfully submitted,

KASS, GOODKIND, WECHSLER & GERSTEIN

By 

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SAMUEL KOPET,

Appellant,

against

ESQUIRE REALTY CO., ETAL.,

Appellees.

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK

ss.:

I, Victor Ortega, being duly sworn,
deposes and says that deponent is not a party to the action, is over 18 years of age and resides at
1027 Avenue St. John, Bronx, New York
That on the 14th day of April 1975 ~~1974~~ at 1 New York Plaza, N.Y. N.Y.

deponent served the annexed *BRIN*

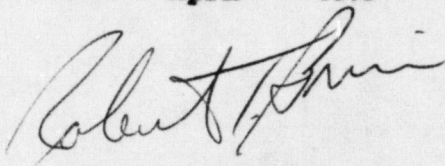
upon

Herman Odell

the Attorneys in this action by delivering a true copy ² thereof to said individual ^{CS}
personally. Deponent knew the person so served to be the person mentioned and described in said
papers as the Attorney(s) herein,

Sworn to before me, this 14th
day of April 1975 ~~1974~~

Victor Ortega
Print name beneath signature
VICTOR ORTEGA



ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975
1977